MAY 2012

QUARTERLY COMMODITY INSIGHTS

BULLETIN

KPMG

cutting through complexity

Q1 – 2012

Gold Aluminum Copper Diamonds Iron Ore Metallurgical Coal Nickel Platinum Potash/Phosphates Rare Earth Metal Thermal Coal Uranium

Gold

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Commodity outlook

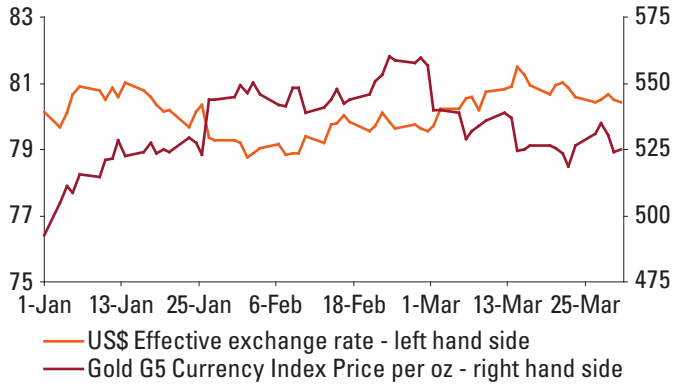
Amid a volatile environment, during the first quarter of 2012, gold prices rose ~8.6 percent, from the beginning of the quarter, to reach US$1,662.50/oz by the end of the quarter. While the average quarterly price, of US$1,690.57/oz, increased marginally (by 0.2 percent) over the last quarter of 2011, it was up 22 percent on y-o-y basis. It was a challenging quarter for gold, as improved economic environment in the US and the market opinion on the expectation of loose monetary policy kept the gold prices volatile. Moreover, elevated rupee volatility and import duty and jewelry tax hikes in India, along with lower Q1 macroeconomic numbers in China, added to the price volatility during the quarter.

Figure 1: Gold prices over years

Source: World Gold Council

An earlier edition of commodity insights bulletin on gold (published on 12 August 2011) highlighted the findings of a study (conducted by GFMS Limited on behalf of World Gold Council) — that gold acts as a suitable hedge against the US dollar. The Q1 2012 gold price movement corroborated the study's findings, as depreciation in the US dollar led to price increases in gold and vice versa (see Figure 2).

Figure 2: Gold prices vs US dollar (Q1 2012)

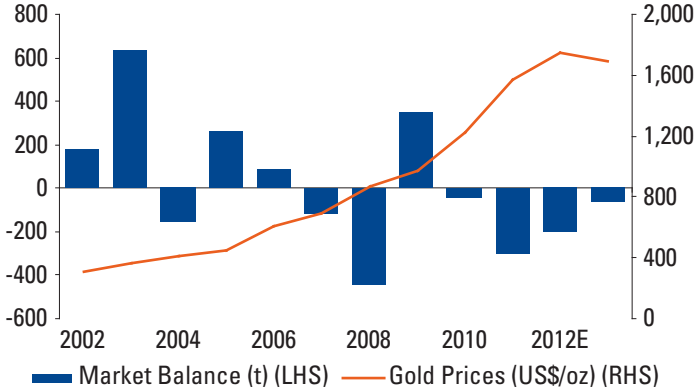


Source: World Gold Council, Bank of England, KPMG analysis

The rise in gold prices in the first nine months of 2011 was offset largely by the downturn in prices in the last quarter. The near about 30 percent gain was reduced to a high single digit for the year, mainly due to economic uncertainty and constrained supply.

According to a World Commodity Forecasts report by the Economist Intelligence Unit (EIU), the market is expected to remain in deficit in 2012 (see Figure 3), as the investors demand persists, especially in Asia. Economic uncertainty is also expected to support the prices, even though volatility is expected to continue throughout the year. The outcome of the eurozone crisis will also have an impact on the prices, with profit booking, either to offset losses or to invest profits in other assets, providing a downward risk to the prices.

Figure 3: Gold market balance vs price



Source: World Gold Council, EIU, KPMG analysis

Forbes believes that gold is facing short-term challenges due to rising bond yields, stronger US dollar and improving US economy. However, in the medium to long run, the situation is expected to improve. It quoted Dundee Wealth Economics' Chief Economist Martin Murenbeeld's views that monetary reflation is a positive factor for gold. Over the last seven months, central banks have taken122 stimulative policy measures globally and historically liquidity injection has acted as a propeller for the gold prices. With further increase expected in monetary base, gold prices are expected to remain high in the coming years.

The price estimates of different financial institutions and research houses can be seen in the table below.

Table 1: Gold price forecasts

Broker/ Institute	2011P	2012E	2013E	2014E	2015E	2016E	2017E
UBS**	1,571	1,680	1,725	1,400	1,300	1,250	1,264
Morgan Stanley*	1,546	1,845	2,175	1,900	1,700	1,500	1,300
Credit Suisse*	1,570	1,689	1,858	1,575	1,400	1,352	1,363
Scotiabank GBM**	-	1,750	1,750	1,750	1,500	1,400	-
BMO Nesbitt Burns**	-	1,600	1,500	1,300	1,100	-	-
Canaccord Genuity**	-	1,725	1,650	1,500	1,500	1,500	1,725
CIBC World Markets**	-	2,000	2,200	1,200	-	-	-
Societe Generale**	-	2,175	2,400	-	-	-	-
TD Newcrest**	-	1,700	1,800	1,600	1,000	-	-
BREE**	1,569	1,814	1,800	1,656	1,494	1,388	1,285

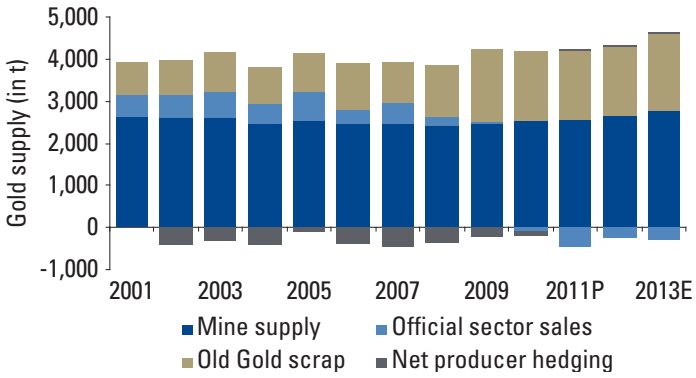
Source: UBS, BREE, Scotiabank, KPMG analysis
*Data as of February 2012, **Data as of March 2012

Supply and demand

Supply

- China, the world's largest gold producer, witnessed 5.9 percent y-o-y increase in its production during 2011. However, the growth rate declined from 8.6 percent in 2010 and is expected to decline further in the future, as Chinese government is expected to bring stricter safety norms and environmental regulations in the mining sector.

Figure 4: Global gold supply, 2001–13E



Source: World Gold Council, EIU, GFMS

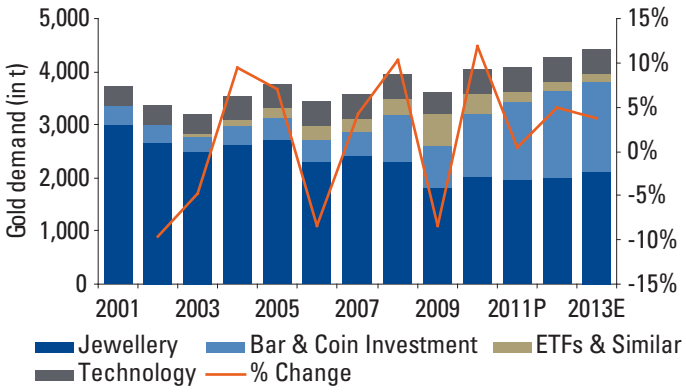
- Production in South Africa, a traditional producer, decreased by 2.3 percent in 2011, due to aging mines and reduced profitability. Production activity is expected to remain subdued in the country in the coming years.
- Production of gold in Canada increased by 7.7 percent in 2011, albeit on a low base of 2010. Thus, moving forward, the output growth is expected to be at a lower rate. In the US, the start up of new mines and higher grades at Cortez Hills mine (Barrick) helped the country increase production by 2.7 percent y-o-y in 2011.
- There was a negative impact on gold production in Australia because of the floods in the first half of the year. Nevertheless, the production capacities resumed operations in the second half and the growth rate is expected to stabilize at its normal level in the coming years.

  The volume of recycled gold remained flat in 2011, falling one percent on the 2010 level. However, EIU expects this volume to increase in the coming years, when gold holders start selling gold, in expectations of fall in prices.

Demand

- On the other hand, Central Banks' role as net buyers increased significantly, with 440t of net gold purchases in 2011, compared with 77t in 2010. Buying activity was particularly strong in the Philippines, Russia, Bolivia and Thailand in 2011. Central banks are expected to continue to be net buyers, with a view to diversify their asset portfolios for securing against economic uncertainty. However, the pace of growth is expected to slow down.

Figure 5: Global gold demand by usage, 2001–13F



Source: World Gold Council, EIU, GFMS, KPMG Analysis

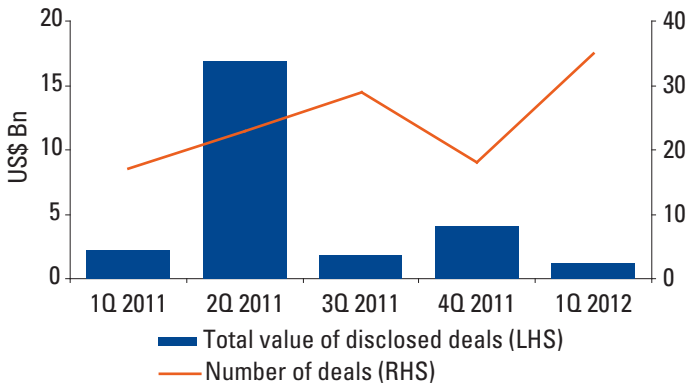
- The recently published World Gold Council (WGC) data show that demand for gold in 2011 increased by only 0.4 percent. The low growth rate was mostly due to the 14 percent decline in the demand for gold jewelry in India. However, investment growth and demand from ETFs remained strong, resulting in a net gain in the demand for gold for the year.
- With deregulation of China's gold market in 2010, China was expected to eclipse India as the top global consumer over the next few years. However, it appears as if China will overtake India as the world's largest consumer of gold in current year only.
- In the market for gold jewelry, high prices have resulted in reduction of consumption in Europe, the US and the Middle East. In India too, high prices and weaker Indian rupee resulted in a marked decline in consumption. Jewelry demand in India is expected to remain price sensitive, thus remaining subdued over the short term. However, demand from China and Hong Kong grew at 14 percent and 13 percent, respectively, in 2011, and is expected to continue to grow, albeit at a lower rate, in the coming years.
- Growth in gold investment in China was 43 percent in 2011. Chinese consumers tended to buy gold as a hedge against inflation, considering gold a safer bet than the stock market and the inflated property market. The demand growth is expected to persist in the near term, as the real deposit rates stay in the negative territory and the People's Bank of China tries to increase its gold reserves (1.8 percent of total reserves at the end of first quarter of 2012).
- For the first time in two decades, Central Banks turned net gold purchasers in 2010. Due to the financial crisis, banks have been expanding reserves, with central banks and government institutions buying a total of 440t of gold in 2011. Gold accounts for 77.1 percent of the reserves in the US and 74.0 percent in Germany whereas it accounts for just 1.8 percent of the reserves in China, 9.7 percent in Russia's and 10.5 percent in India, which indicates that Central Banks may continue to buy gold.
- Demand for gold ETFs declined in the first half of 2011 but grew in second half due to the eurozone crisis. However, because of profit taking and rebalancing, the demand for the year was down considerably to 154t, the lowest level touched since 2004. EIU expects the demand to grow in the coming years, but at a slower rate.

Key developments

Ownership changes

In the first quarter of 2012, the total value of announced deals in the gold industry declined to US$1.15 billion, from US$2.26 billion in the first quarter of 2011, representing a y-o-y decrease of 49 percent (as shown in Figure 6). However, the number of deals announced in the first quarter of 2011 increased from 18 to 35, against the last quarter of 2011. Out of a total of 35 deals, four deals have already been successfully completed.

Figure 6: Value of deals announced in gold industry*



Source: Intierra, Merger Market, KPMG Analysis
*Excluding failed bids

- In the first quarter of 2012, Canada was at the center of merger and acquisition activity, as 16 of the 35 announced deals had a Canadian acquirer, target or both.

Table 2: Top gold deals announced in Q1 2012 (on the basis of value)

Date announced	Target	Target nation	Acquirer	Acquirer nation	Status	Value of transaction (US$ million)	Stake (%)
30-Mar-12	Absolute Gold Holdings Incorporated	Canada	GoGold Ressources	Canada	In progress	75.45	100
27-Mar-12	Northgate Australian Ventures Corporation Pty Ltd	Australia	Crocodile Gold Corp.	Canada	In progress	80.21	100
7-Mar-12	Finkolo Gold Project*	Mali	Resolute Mining Limited	Australia	In progress	20.00	40
3-Mar-12	Ezulwini Gold/Uranium Mine*	South Africa	Gold One International Limited	Australia	In progress	70.00	100
20-Feb-12	Okvau Gold Project*	Cambodia	Renaissance Minerals Limited	Australia	In progress	42.89	100
20-Feb-12	Blanket Gold Mine*	Zimbabwe	Various	Zimbabwe	in progress	39.09	51
13-Feb-12	Blyvooruitzicht Gold Mine*	South Africa	Village Main Reef Limited	South Africa	In progress	24.34	74
9-Feb-12	Vivien Gold Deposit*	Australia	Ramelius Resources Limited	Australia	In progress	10.80	100

Date announced	Target	Target nation	Acquirer	Acquirer nation	Status	Value of transaction (US$ million)	Stake (%)
8-Feb-12	Pachamama Resources Ltd	Canada	Regulus Resources Inc	Canada	In progress	47.24	100
8-Feb-12	Bullion Monarch Mining, Inc.	United States	Eurasian Minerals Inc	Canada	In progress	45.80	100
7-Feb-12	Kekura Gold Project *	Russia	Sharprock Resources Inc.	Canada	In progress	240.00	75
3-Feb-12	Sega Gold Project*	Burkina Faso	Cluff Gold plc	United Kingdom	In progress	30.28	90
30-Jan-12	Evander Gold Mine*	South Africa	Pan African Resources and Witwatersrand Consolidated	South Africa	In progress	219.14	100
23-Jan-12	Stonewall Mining (Pty) Limited	South Africa	Meridien Resources Limited	Australia	In progress	69.95	100
23-Jan-12	Rift Valley Resources Limited	Australia	Brightstar Resources Limited	Australia	In progress	14.17	100
8-Jan-12	Grosvenor Gold Pty Ltd	Australia	Resource & Invest NL	Australia	In progress	35.83	100
5-Jan-12	Prosperity Goldfields Corp	Canada	Smash Minerals Corp	Canada	Complete	18.59	100

Source: Intierra, Merger Markets, KPMG analysis
* Note: The target in this case is a property/portfolio, and not a company.

Regulatory updates

The regulations introduced in the first quarter of 2012 were intented to generate additional revenues for the government through new levies or higher taxes and duties and for conserving benefits of the natural resources for the local community.

Table 3: List of recent regulations regarding gold industry

Country	Regulation	Description
India	Import tariffs	The Indian government slashed the import tariff value of gold by 7.5 percent from US$573 per 10 grams to US$530. This is expected to provide a breather to the industry, which recently saw an increase in duties and taxes.
India	Custom duties/import duties	India hiked import duty on gold by 90 percent in January 2012 by changing it to two percent of value from the earlier flat amount of INR 300 (~US$6) per 10 grams. Then again in the current year's budget, Finance Minister Pranab Mukherjee announced an increase in the duty to four percent.
United States	The General Mining Act of 1872	The Obama Administration is planning to introduce royalties on gold, silver and copper, which are currently exempted under the General Mining Act of 1872.

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